DOW THEORY LETTERS INC.

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36 Letters per Year — $60.00 Annually

Registered with the Securities Exchange Commission

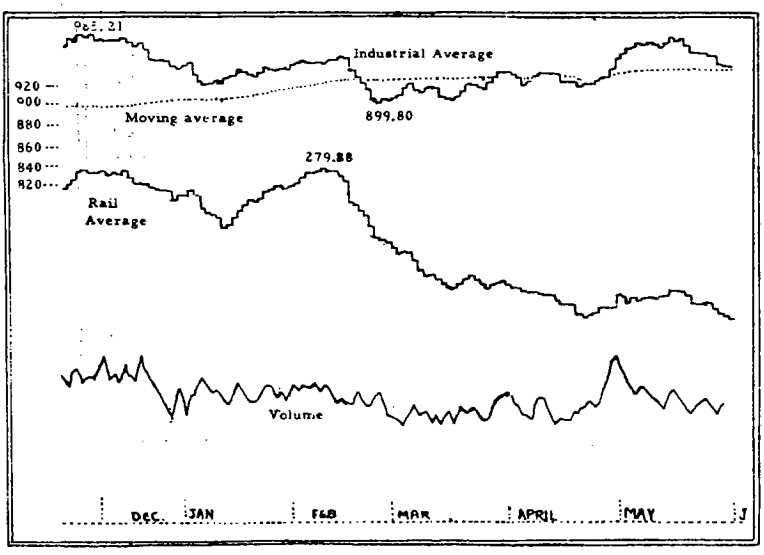
June 4, 1969 Letter 429

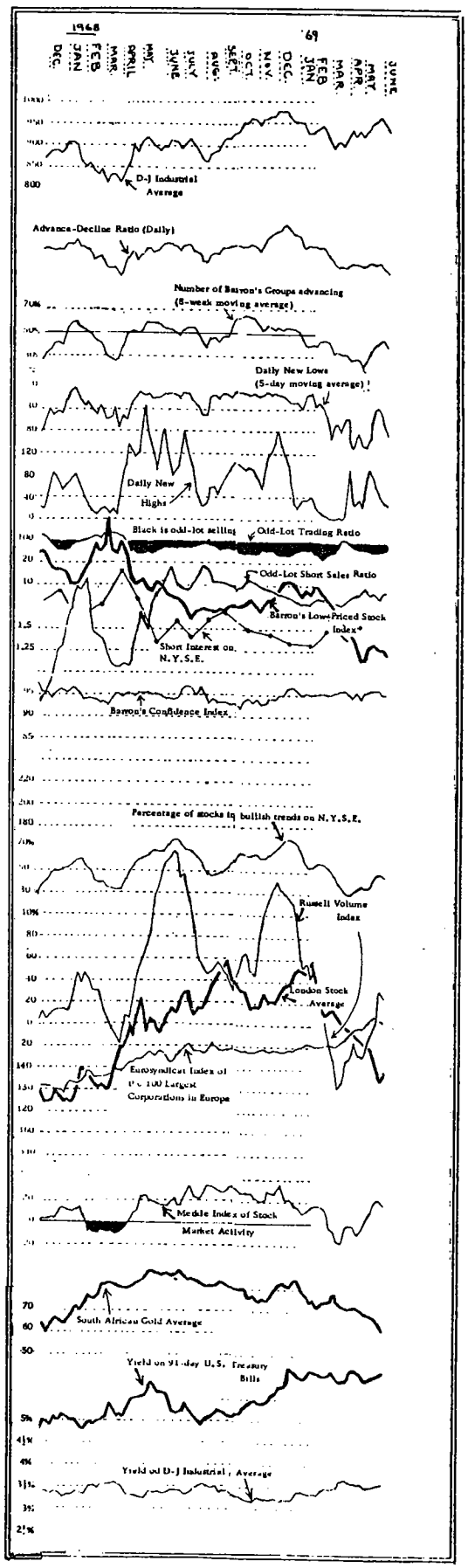
THE MARKET: The Dow Industrials have now given up more than 50% of the gains registered from the 899.80 rally starting point of February 25, 1969 to the 968.85 1969 peak. The Rail Average is only a fraction above its 1969 low. The Utility Average too is only a fraction from a new 1969 low. The D-J 40 Bond Average is a mere 23¢ from its 36-year low of 73.00. The advance-decline ratio is at a new 1969 low and therefore below its 1968 low as well. The advance-decline ratio is, at the same time, only slightly above the extreme low registered in 1966.

This latter situation is extremely significant since the advance-decline ratio measures the advancing and declining tendencies of all stocks on the N.Y.S.E. The fact that the A-D ratio is at a new 1969 low means that the majority of stocks on the Exchange are at or near their 1969 lows, and this is confirmed by the sudden surge in daily New Lows. A continuation of the decline could easily take the A-D ratio below its extreme 1966 low, and if this occurs I would expect to see New Lows explode to shocking proportions.

The collapse of the A-D ratio and the sudden rise in daily New Lows means that many speculators are now trapped in this primary bear market. A breaking of the 1966 low by the A-D ratio would suggest that a majority of issues on the N.Y.S.E. are near or under their lows of the last few years. Such action would imply gathering losses to "investors" and speculators on all transactions completed since 1966.

In the bond markets, the losses are already of fantastic proportions. The banks, which are now "loaned up," have been forced to unload their investment portfolios, their government securities and municipal bonds. But lately, there has been no market for the huge mass of bonds which are up for sale. As a result, bond yields (in the face of demoralized bond markets) have spiraled through the roof.



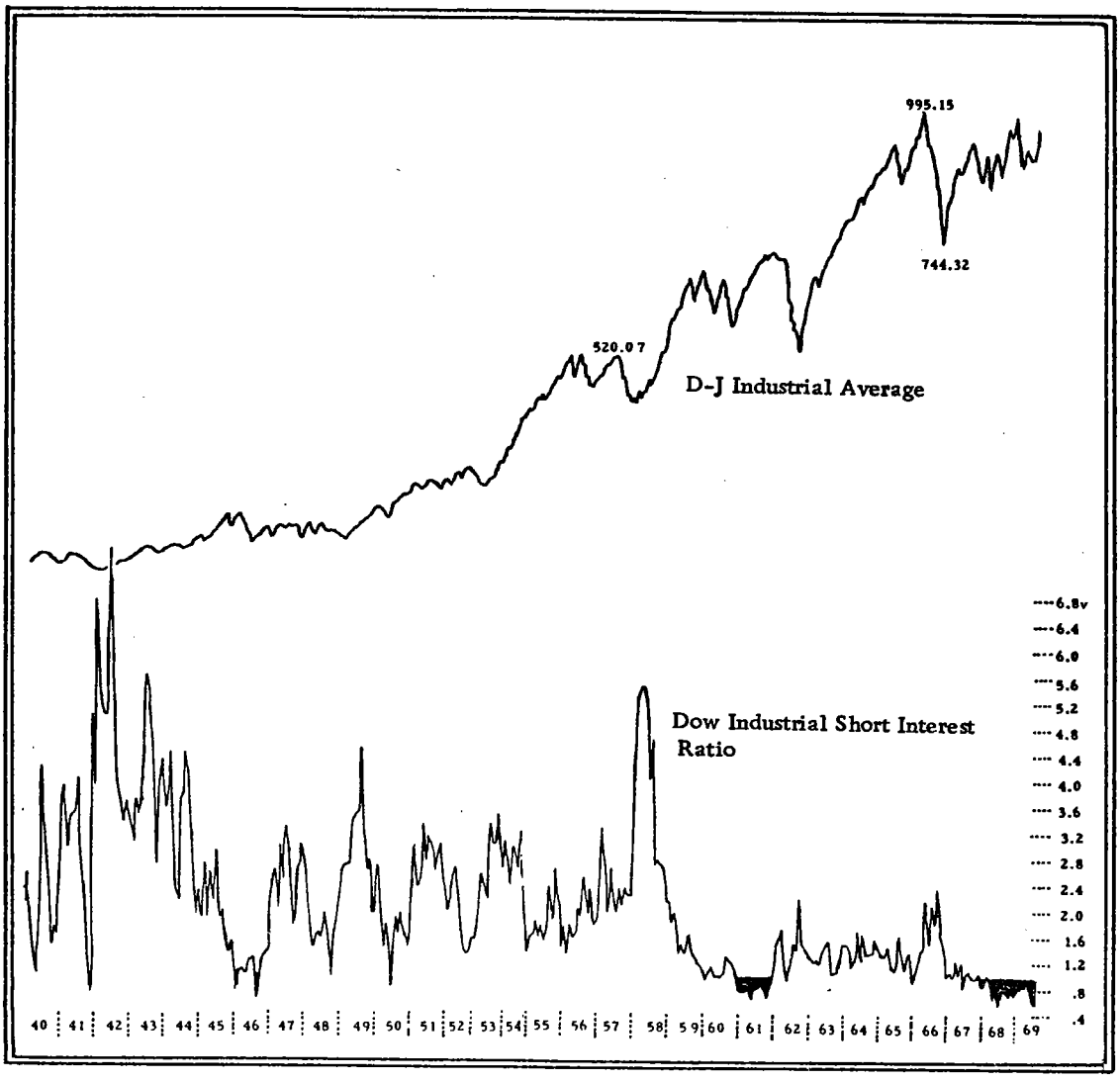

1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index*
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of 100 Largest Corporations in Europe
Middle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield on D-J Industrial Average

The next step for the banks is halting loans or actually calling loans. Any further dumping of bonds is calculated to turn the money markets into sheer chaos, and it is up to the banks whether they are willing to try to unload their debt securities in a bond market which teeters on the brink of panic.

There are optimists who are saying that things are no worse now than they were in 1957 or 1962. But I believe they are wrong. Business liquidity is now at low levels, there is little likelihood of higher corporate profits during the remainder of 1969, the stock-bond yield spreads are now more negative than they were in 1929, hundreds of billions in bond portfolios are registering severe losses, new bond financing (which last year amounted to six times new equity financing) is facing shattered market conditions, and the banks are strapped for cash.

In the face of all this, the stock market will now have to decide whether the economy and Washington can find "another way out." If the Government is serious about stopping inflation I must confess that I do not see any way out save deflation, and I do not think it will be "fine tuning" deflation as our Washington leaders promise.

As far as I am concerned, the correct procedure continues to be the same as the one I advocated ever since the 1966 top. That is, all assets in 91-day Treasury bills ("rolled over" every 91 days) with a hedge position of 10% to 15% in gold shares. Those subscribers who have assumed such positions have obviously not scalped any profits during the 1966-69 rise, neither are they sweating now as 10% or more of the stocks on the Big Board hit new lows each day. They have also practiced correct Dow Theory procedure, and can rest in the knowledge that they should be in excellent shape as this primary market meets its ultimate rendez-vous with a bottom which will probably arrive amid chaotic conditions sometime during the next few years.



DOW SHORT INTEREST RATIO: This is the indicator developed by Bill Gordon writing for Indicator Digest. I like this indicator because (1) it renders very few signals, (2) when it does give a signal, the signal is unmistakably clear, and (3) the indicator is not widely followed. In fact, I am the only one who publishes a chart of the Dow short interest on a regular basis.

The Dow short interest ratio (DSI) is the ratio of the short interest in the 30 Dow Industrial stocks to the trading volume in those stocks over a one month period. Since 1934 there have only been five instances when the DSI dropped under the critical 1.0 level. These instances were 1939, 1941, 1946, 1961 and the present (see chart).

Each of those areas were accompanied by a decline, but the first three were minimal signals in that the DSI held below 1.0 for no longer than two months. Then we come to the 1961 situation. In January, 1961, the DSI dropped to .71. It held in the below-1.0 area to January, 1962, a period of 13 consecutive months. This extended "danger zone" was followed by the severe smash of 1962.

In January, 1968, the DSI slipped to .85. Except for the single month of March, 1968, when the DSI climbed to 1.13, the DSI has held under 1.0 ever since. Here are the figures: Jan., 1968 was .85, Feb., .85, Mar. 1.13, April .84, May .64, June .87, July .53, Aug. .85, Sept. .74, Oct. .79, Nov. .79, Dec. .70; Jan., 1969 was .74, Feb. .82, Mar. .81, April .84, and the latest figure just received is a very low .59 for May, 1969.

Except for the .53 registered in July, 1968, the latest .59 figure is the lowest DSI reading in 30 years. Furthermore, it is well to note that the only previous extended under-1.0 area (marked black on the chart) occurred in 1961 when the DSI held in the danger zone for 13 consecutive months. Starting with January, 1968, we have now held under 1.0 or in the danger zone for 16 out of 17 months. Thus, the DSI is now screaming danger. There is nothing comparable to the present reading on the DSI in history. What more can I say?

TIME GOES BY: It has been three-and-one-half years since the 1966 top. During that time almost every market analyst in the nation has turned bullish on the primary trend (Granville, Schaefer and I have been exceptions). Few analysts take the trouble to study the big picture. The pressure is always on the men in Wall Street to give the public "action" for their money, so why talk about a bear market when everything continues to hold up so beautifully?

Dow's Theory deals in concepts and investment procedures which have held up well over the years. The Theory is not a trading technique, nor is it an infallible method of producing fat profits every year. Dow's Theory is basically concerned with the tidal concept of the market, and the tide takes time to come in or run out.

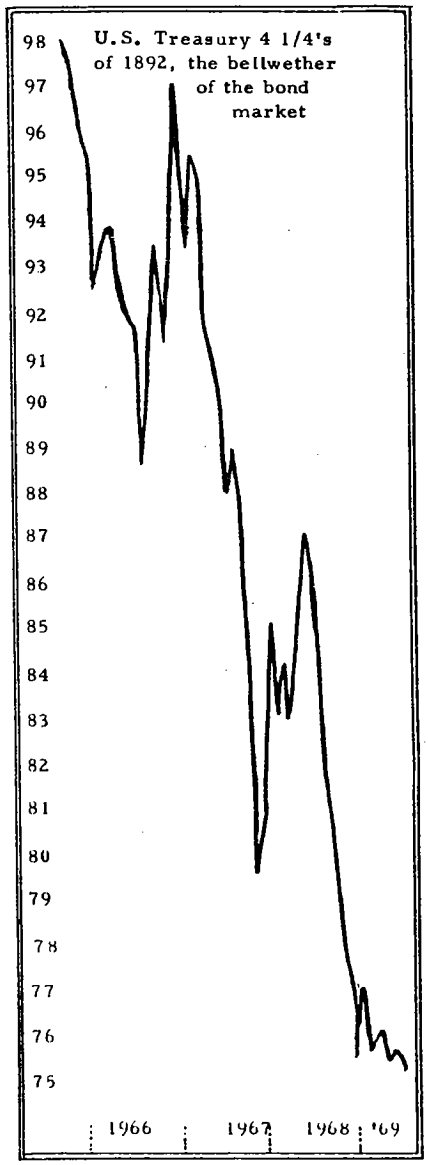
Those who buy early in a bull market may have to sweat out reaction after reaction until the ultimate upside blow-off produces major profits in their portfolios. And those who elect to stay liquid during a bear market must resist the siren song of Wall Street through every upward correction, no matter how weak or powerful that rally may be.

Since the 744.32 low of 1966, the market has been engaged in one of the most persistent and extraordinary rallies in the history of the exchanges. Nevertheless, in the classic Dow Theory manner the Industrial and Rail Averages have stubbornly refused to better their 1966 highs together. Note on the accompanying chart that since 1966 we have had three descending tops in Industrials, the 995.15 of 1966, the 985.21 of 1968 and the 968.85 of May 14, 1969. Despite the series of two

unconfirmed highs in the Rail Average (274.49 in 1967, 279.48 in 1968), the Averages are not acting as if this were a bull market.

I have mentioned repeatedly that the longer the primary trend is held back, the more violent and relentless the ultimate expression of the primary trend. My feeling is that the three-and-one-half years' grace since 1966 is not really a bargain or a "bail-out" for the market. Rather, it is a period wherein even greater excesses have been built into Wall Street and the economy. I do not take satisfaction in the way the market has held up since the 1966 bull market top. I see it as an ominous preamble to major downside action which may shock the heart of even the staunchest bear. I feel it is unfortunate that our money managers have been trying to manipulate the primary trend. Instead of taking in the nation's sails in preparation for bad weather ahead, they have hocked the ship and sold the life rafts.

As a final note I draw readers' attention to what I consider an ominous technical development, and one which has called severe reversals many times in the past. The development is what I term a "double non-confirmation" of the two Averages. At the 1968 highs, the Rails bettered their 1967 (and 1966) peaks but Industrials failed to better the 1966 high. A decline followed. Then on the 1966 rally the Industrials bettered their earlier February, 1969 high of 952.70. But here Rails turned sluggish, refusing to hurdle any of their previous 1969 peaks. Thus we have a non-confirmation by Industrials during late 1968, followed by a non-confirmation by Rails in 1969. When first one Average, then the other refuses to confirm I term it a rare double non-confirmation. Such double non-confirmations have correctly identified many bottoms and many tops. In this case, I believe there is a good chance that we have seen the top.



CRUNCH: I believe in charts. They eliminate all the subtle "alterations" of the facts, they cut through the hopes, wishes and pleasant verbiage. I have expressed continual fears about the bond market in Letters this year. The accompanying chart tells the story. It really does not need alot of description, but I'll include some anyway.

The 4¼ Treasury bond of 1987-92 is considered the bellwether of the Treasury bond market. Last week the 4¼ broke to the 74 level, its lowest level since issuance in 1962. Those who purchased this bonded debt of the U.S. Government are now sustaining losses up to 25%. They bought it when its coupon was yielding approximately $42.50 for each $1000 bond. At its current price, the bond (had you purchased it when it was issued) would have provided you with a loss of around $250 or six years' interest.

What about purchasing the 4¼ of 1987-92 at its current price of around 75 (i.e., $750) with a yield of 6.33%, why wouldn't this be a brilliant idea? I don't know, maybe it would be brilliant. But I again caution readers as I did in the last Letter. Most bear markets in bonds terminate amid a credit crisis (with ensuing credit liquidation). We're not quite there yet.

Perhaps the simplest way of looking at the bond market is to say that bonds are now reflecting the oncoming of the biggest monetary and credit mess since 1929. The current inflationary trends cannot continue against a background of high interest rates and vanishing money. The whole structure upon which the stock market and bond markets have been erected is unsustainable. That's the word, unsustainable.

On May 27, the day when the Treasury 4¼'s touched their historic low of 74, I noted this quote in the Wall Street Journal "Bond Markets" section. I thought it was rather ominous: "There was an emotional reaction to prices when several holders offered their bonds for sale, only to learn there simply weren't any takers."

The following day when the Treasury 4¼'s plunged to historic lows under 74 the Journal headlined the bond market as follows, "Many Key Prices Plunge: Conditions Termed the Most Disorderly in Memory." One specialist was quoted as saying, "For practical purposes, portions of the (bond) market have ceased to exist, as there simply aren't any takers to balance out the large numbers of potential sellers."

If it's any consolation, our sister in inflationary policies, England, is faring worse than we are. The British stock indices are now down 20% from their recent highs. Following is a quote from the London Economist (May 24) regarding the gilt-edged (government bond) index: "On Wednesday, the Financial Times gilt-edged index fell to the lowest level it had ever recorded since its introduction 42 years ago, and the fall during the day was the biggest since devaluation."

ONWARD AND UPWARD: This Administration does not seem fated to have anything easy. For instance, with all the pressure on the monetary system the latest April figures showed consumer prices rising at an annual rate of 7.2%, down from March's ridiculous 9.6% but still very, very inflationary. Wholesale prices during May rose at an annual rate of 7.2%, three times the April rate. Labor costs jumped 2% in the first quarter. To reduce the monetary pressure in the face of these statistics would be to admit defeat.

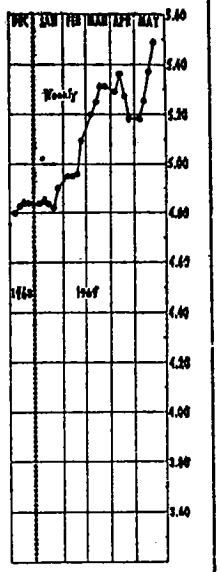
In all fairness, however, it must be said that to allow inflation to continue at its current rate is to face certain disaster. Europeans, already worried, know full well what the ravages of inflation can do to a currency, and the U.S. anti-inflation policies, if nothing else, must convince our European creditors that our hearts and minds are in the right place.

But the sources of credit are now drying up, and no securities market in history has ever continued against steadily contracting credit. Federal Funds (the money one bank lends another) have risen to the 10%-13% level, which means that this source has about dried up. Certificates of Deposit issued by the banks are actually being siphoned off (because of higher available rates elsewhere). With the C/D limit at 6.25%, the total of C/D's is now down $7 billion from the record high of $24.3 billion registered last December.

The big source of credit for the nation is commercial paper and bank acceptances, with both of these sources now drawing 7% and more interest. Another source which has about run out is Eurodollars, which are up 50% since January (up $3.2 billion). Eurodollars are bringing 9.25 to 10%, and at that rate the Eurodollar market has about had it as a new source for dollars.

The final source of money for the banks is their own holdings of government and tax-exempt bonds. The writing is on the wall here too. From the mid-December peak of $64.3 billion, bank holdings of governments and tax-exempts have dropped $6.5 billion to the current $57.8. The pressure in the bond markets as the government and tax-exempts are unloaded can be seen in this chart of tax-exempt yields (put out each Monday by the Wall Street Journal). Last week the yield of Tax-exempts jumped to the highest level since the early 1930's (when credit distress was rampant), to 5.60% yield.

Municipal Bond Yield



ODDS AND ENDS:

Myer's Finance Review announces in its latest report: "Resulting from new doubts about paper money, Myer's Finance Review makes this offer—50% of the subscription price for any term if delivered in U.S. silver coinage." Mr. Myer of Canada is either a skeptic or a realist. Maybe these days, to be one is to be the other.

* * * *

Nothing halts the public's overriding faith in inflation. Else, why would mutual fund sales go to an all-time high in April as per the enclosed clip? As Congressman Powell used to say in New York, "Keep the faith, baby." And I comment, "keep it, it's all yours."

* * * *

Cumulative Average notes: "Maybe investors are beginning to realize what we have often said that the unrealized capital losses that banks have sustained from the decline in bond prices wipes out all banks' earnings and half of their net worth as well. Some have no net worth at all if current market value of their portfolio is used for accounting."

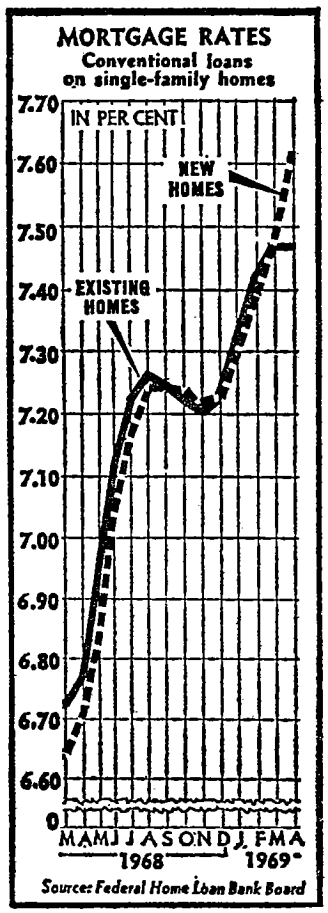
* * * *

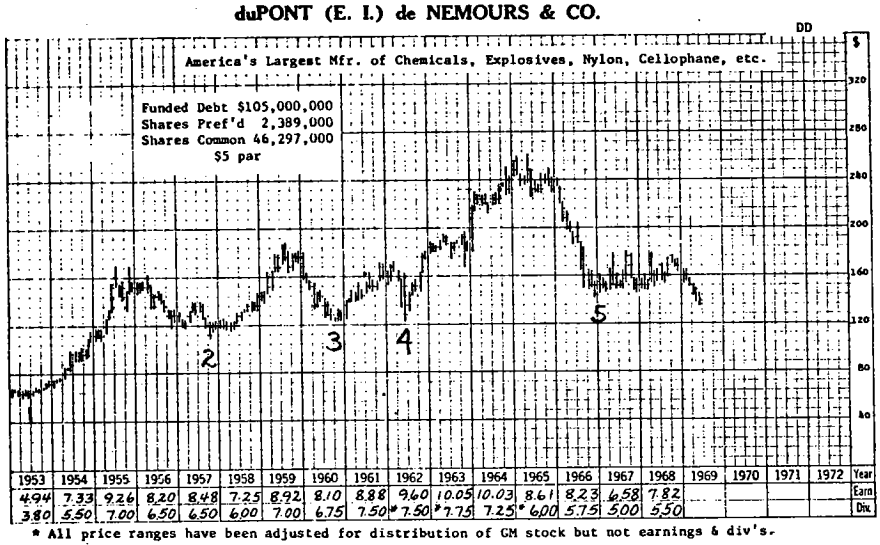
How to hold back the booming rate of corporate loans; Roy Reierson, senior vice president of the huge Bankers Trust Co. suggested that the prime rate go to 10%, just to "shock" businessmen into cutting back on their spending.

FUND SALES SET RECORD FOR APRIL

NEW YORK (DJ)—Mutual fund gross sales set a new high for the month of April at $654,-286,000 vs. last year's $618,002,000, the Investment Company Institute reported Wednesday. Sales also exceeded March sales of $628,146,-000.

Mortgage rates continue to go through the roof as this chart shows. With conventional loans above 7.6% (plus points), I would suggest that instead of buying a house you rent same, and put the money into mortgage loans (I'm being a bit sarcastic here, but maybe you should go ahead if you can find a guy who is a top risk). Trouble is that a fellow who is a top risk today is liable to be very conservative, and if he is, why would he be taking out a mortgage at these prices?





STOCKS: Strange things are happening. Take DuPont, America's largest chemical complex. Note on the monthly chart (courtesy of M.C. Horsey, Salisbury, Md. 21801) that from the inception of the big move in 1949, each reaction bottom in DD has been higher than the last. These ascending bottoms are numbered one through five on the chart. But last week DD broke under 140, thereby penetrating the 1966 low and reversing a series of ascending patterns which has held since the late-1940's.

I consider DD breaking to a six-year low to be a serious commentary on today's market. This huge corporation together with General Motors (as I have commented upon many times before) tends to be a bellwether of the blue-chip market. There are few areas of the U.S. economy into which DD's activities do not extend. This stock is now in serious trouble, and anything below 120 would appear to be a smash. Personally, I would guess that DD is leading the way for the rest of the market. I have seldom seen Wall Street stand up against this type of action in DD.

One of the characteristics of this market is that when stocks break down, they really mean business. A typical example is the Bucyrus-Erie action of last week. Note on the daily chart that in three days of trading BY suddenly plunged below its entire 1969 trading range and also broke below its late-1968 level. Thus in the space of 15 hours BY gave paper losses to all who had held it over the past year. Not a very pleasant situation. (Chart courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002).